Submission FIN 00414-18: FB#5 Amendment to Capital Acquisitions Tax Consolidation Act 2003

TO:	Minister	AUTHOR:	Aileen Gleeson
STATUS:	Completed	OWNER:	Aileen Gleeson
PURPOSE:	Finance Bill	REVIEWERS:	Pat Leahy John Hogan
DIVISION:	Tax Division		
DECISION BY:			

Final comment

Agreed, and so it begins! PD 07/06/18

Action required

To approve an amendment to section 86 of the Capital Acquisitions Tax Consolidation Act 2003 in Finance Bill 2018 to address the use of discretionary trusts for the avoidance of Capital Acquisitions Tax.

Executive summary

Capital Acquisitions Tax (CAT) is a tax applied to inheritances and gifts accumulated over a certain tax-free threshold, determined by the relationship of the parties involved. An individual may qualify for relief from CAT under certain circumstances. Amendments were made in Finance Act 2016 to reinstate the original policy objective of the Dwelling House relief.

Under the current regime, an exemption from CAT is allowable on the inheritance of a dwelling house when certain conditions are met. One condition is that the individual must have lived in the property for the three years immediately prior to the inheritance. Another condition is that the individual must have no beneficial interest in any other dwelling house at the date of inheritance. However, it has come to light that in order to circumvent this second condition, some successors are transferring their interest in a dwelling house into a discretionary trust where the successor is the beneficiary of the trust. They can then inherit another dwelling house and qualify for the exemption on the basis that they don't have a beneficial interest in the property held in trust. This practice goes against the spirit of the Dwelling House Relief.

In order to preserve the policy objective of the relief, it is recommended that an amendment be made to section 86 of the Capital Acquisitions Tax Consolidation Act 2003 to prevent the use of discretionary trusts to circumvent the requirement to pay CAT.

Detailed information

Background:

A relief on the transfer of residential property (dwelling house) between close relatives was introduced in 1991. The policy objective was to prevent the hardship of the forced sale of property to pay inheritance tax where the person inheriting had lived there and had no interest in another property. The scope of the exemption was extended in 2000 to include gifts of dwelling houses and any beneficiary (not just close relatives) could now claim the exemption. The unintended consequences of these changes were that properties could be purchased for adult children and after three years had passed these properties could then be gifted to the children free from CAT. These practices were contrary to the original policy objective of the exemption.

In order to reinstate the policy objectives of the relief, changes introduced by Finance Act 2016 (section 52) significantly restricted the relief, particularly in relation to providing tax-exempt gifts of dwelling houses. In relation to inheritance, the changes restricted the exemption to the principle private residence of the disponer (the person providing the property). The requirement for the successor to have no beneficial interest in any other residential property at the time of inheritance was unchanged.

It has come to light that in order to circumvent this restriction, a successor can transfer their interest in a dwelling house into a

discretionary trust, allowing them to then inherit another dwelling house and claim the CAT exemption. A discretionary trust is an arrangement whereby property is set aside in a trust. The trustee has discretion over when they may pay or apply income to the beneficiaries and the beneficiary has no interest in the trust assets. Therefore, in transferring their interest in a property into a discretionary trust, the beneficiary will meet the requirement of having no beneficial interest in another residential property, thus allowing them to access relief on CAT on inheritance of another property. It may even be the case that the successor is the sole beneficiary of the trust.

As the changes introduced by Finance Act 2016 were designed to reinstate the policy objectives of the relief as first introduced, allowing this type of practice to continue goes against the spirit of the relief.

A similar issue had previously arisen for the 'farmer test' in the context of CAT agricultural relief (section 89 CATCA 2003). The purpose of the 'farmer test' is to establish that the value of agricultural property makes up at least 80% of the beneficiary's total property value, thereby allowing for relief from CAT. In order to meet this requirement, the beneficiary could put some assets into a discretionary trust as a way of circumventing the test. This was addressed by deeming the beneficiary to be beneficially entitled to any property held in a discretionary trust.

Recommendation

It is recommended that section 86 CATCA 2003 be amended to ensure that where a successor claims the dwelling house exemption, the successor is deemed to be beneficially entitled to any property that has been placed in a discretionary trust which the successor has established and of which they are the beneficiary at the date of the inheritance. This should be introduced from the date of the passing of the Bill.

Officials are available to discuss.

Related submissions

There are no related submissions.

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Submission FIN 00417-18: FB19#23 Technical amendments to Capital Acquisitions Tax Consolidation Act 2003 (FB 2018)

TO:	Minister	AUTHOR:	Aileen Gleeson
STATUS:	Completed	OWNER:	Aileen Gleeson
PURPOSE:	Finance Bill	REVIEWERS:	Pat Leahy John Hogan Margaret Fitzgerald
DIVISION:	Tax Division		
DECISION BY:			

Final comment

Agreed. PD 21/08/18

Action required

To approve technical amendments to the Capital Acquisitions Tax Consolidation Act 2003 in Finance Bill 2018 to support effective administration and compliance efforts in respect of Capital Acquisitions Tax.

Executive summary

Capital Acquisitions Tax (CAT) is a tax applied to inheritances and gifts accumulated over a certain tax-free threshold, which is determined by the relationship of the parties involved. The Capital Acquisitions Tax Consolidation Act 2003 (CATCA) is the legislation governing the administration of CAT and particular technical amendments have now been identified which will support the effective administration of the tax and will also facilitate Revenue compliance efforts. The recommendations are as follows:

1. Amendment to address the mismatch between the time limit for Revenue to make enquiries and raise assessments (4 years) and the period during which conditions to qualify for certain reliefs must be met in order to avoid a clawback of the relief granted (6 years).
2. Amendment of outdated 'business relief' definitions to align with definitions in the Companies Act 2014.
3. Amendment to provide a legislative basis for the application of a surcharge in the case of the late filing of discretionary trust tax returns.
4. Amendment to correct an anomaly in the treatment of life assurance policies in relation to relief available for CGT paid where both CGT and CAT are payable on the same event.
5. Amendment to reinstate a provision in relation to a due date for payment of CAT determined to be due by the Appeal Commissioners.

Detailed information

The following amendments to the Capital Acquisitions Tax Act, 2003 (CATCA) are proposed for your agreement for inclusion in Finance Bill 2018.

Item 1: Amendment to address the mismatch between the time limit for Revenue to make enquiries and raise assessments (4 years) and the period during which conditions to qualify for the relief must continue to be met so as not to trigger a clawback of the relief granted (6 years).

There are a number of reliefs contained in the Capital Acquisitions Tax Consolidation Act (CATCA) 2003 which provide exemptions from CAT or reductions in taxable value, but which are subject to clawback if certain conditions are not met. In order to avoid clawback of the relief granted, these conditions must continue to be met for a period of 6 years.

The reliefs which have a 6-year clawback period are:

- Dwelling House Relief - a person inheriting a dwelling house must continue to live in the property for 6 years following inheritance.

- Agricultural Relief - a farmer must continue to actively farm the land, or lease it to someone who does, for a period of 6 years following the gift or inheritance of agricultural property.
- Business Relief - the business property must continue to qualify as a 'relevant business property' for 6 years following the gift or inheritance and cannot be sold during that time unless replaced with another 'relevant business property'.
- Heritage Property Relief - the property (including heritage houses) cannot be sold during a 6-year period, except to designated heritage institutions.

This 6-year clawback period is not aligned with the four year time limit for Revenue to make enquiries and raise assessments under section 46 CATCA 2003. In the case of fraud or neglect, this four year time limit may be extended. However, where the individual inheriting the property fails to meet these conditions for 6 years for reasons other than fraud or neglect, Revenue does not have a legislative basis for making enquiries or raising assessments beyond the standard four year period. Addressing this mismatch will support Revenue compliance efforts in the administration of CAT reliefs.

A similar amendment was made in relation to certain stamp duty reliefs in Finance Act 2017 (section 63).

It is recommended that CATCA 2003 be amended as necessary to extend the four-year time limit to a 6-year time limit for making of enquiries and raising of assessments in relation to CAT reliefs which are subject to clawback.

Item 2: Amendment of outdated 'business relief' definitions to align with those contained in the Companies Act 2014.

Section 90 CATCA 2003 contains a number of references to definitions contained in previous Companies Acts. These Acts have since been repealed by the Companies Act 2014. Legal advice taken last year on this matter found that while the older references still have legal standing, it is prudent to update the references in the interests of certainty and clarity.

The definitions in question are for 'associated company', 'holding company' and 'subsidiary'.

It is recommended that section 90 CATCA 2003 be amended as necessary to take account of the Companies Act 2014.

Item 3: Amendment to provide a legislative basis for the application of a surcharge in the case of the late filing of discretionary trust tax returns.

Failure to submit a tax return by a specified fixed date can result in an increased tax liability (a 'surcharge'). Surcharges are widely applied across the various taxheads, including mainstream CAT and are an important compliance tool for Revenue. Discretionary trust tax comprises of an initial 6% charge on the assets held in a discretionary trust on a certain date and an annual 1% charge on the assets held for each subsequent year. The filing dates in respect of the initial and annual discretionary trust tax charges are different from those for mainstream CAT. Consequently, there is currently no legislative basis for the application of a surcharge in the case of the late filing of discretionary trust tax returns.

It is recommended that section 53A CATCA 2003 be amended to provide for a late filer surcharge for initial and annual discretionary trust tax returns.

Item 4: Amendment to ensure equal treatment of life assurance policies in relation to relief available for CGT paid where both CGT and CAT are payable on the same event.

Relief is available under section 104 CATCA 2003 in respect of CGT paid where both CGT and CAT are payable on the same event. This relief can be clawed back if the asset is not retained by the beneficiary for 2 years after the date of the gift or inheritance. The Taxes Consolidation Act (TCA) 1997 contains a provision which deems income tax paid on a life assurance policy on the death of a disponer to be CGT for the purposes of this CAT relief where it is inherited as part of the deceased's estate. As the asset in this case, the assurance policy, matures on death and is converted to cash, it is not possible for the beneficiary to comply with the 2-year holding period and therefore the beneficiary cannot avail of the relief as intended.

It is recommended that section 104 CATCA 2003 be amended to allow that the benefits of life assurance policies on which CGT has been deemed to be paid will be considered to have been held by the beneficiary for the required 2-year period so as to avoid triggering automatic clawback of the relief.

Item 5: Amendments to reinstate a provision which was inadvertently removed by the Finance (Tax Appeals) Act 2015 in relation to a due date for payment of CAT determined to be due by the Appeal Commissioners.

Tax heads such as income tax, corporation tax and capital gains tax have specific legislative provisions specifying the due date for the payment of tax which is determined to be due by the Appeal Commissioners. The position for these tax heads is that following the appeal, any unpaid CAT is due on the original due date, except where at least 90% of the tax was already paid before the appeal. In these circumstances, the due date is one month following the determination of the appeal. While CATCA 2003 previously contained a similar provision, this was inadvertently deleted by Finance (Tax Appeals) Act 2015 and has only now come to light.

As a consequence, the current position is that following an appeal, any unpaid CAT is due on the original due date, regardless of the amount of tax that was paid before the appeal was made. This anomaly vis-à-vis other tax heads needs to be addressed to ensure consistency and fairness across tax heads. A similar amendment is proposed to section 66 CATCA 2003 which provides for an appeal to the Land Values Reference Commission in relation to property valuations. Although the provisions regarding the due date for payment never applied in relation to such appeals, for consistency and fairness, the revised 'due date' provision should also extend to the CAT payable following the determination of such appeals.

It is recommended that sections 66 and 67 CATCA 2003 be amended to provide for a new due date of one month following the determination of an appeal where the tax paid before the appeal was at least 90% of the tax determined to be due.

These recommended amendments should be introduced from the date of the passing of the Bill.

Officials are available to discuss.

Related submissions

There are no related submissions.

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Submission FIN 00881-18: FB19#32 Impact on possible changes to the Capital Acquisitions Tax (CAT) Thresholds and rates.

TO: Minister
STATUS: Completed
PURPOSE: Finance Bill

AUTHOR: Emma Murphy
OWNER: Emma Murphy
REVIEWERS: Aileen Gleeson
Pat Leahy
John Hogan
Margaret Fitzgerald

DIVISION: Tax Division
DECISION BY:

Final comment

Thanks. Noted. Let's deal within tax process that we began yesterday. Could only do if resources allow. PD 31/08/18

Action required

To decide if changes to one or all of the three Capital Acquisitions Tax (CAT) thresholds and rates should be included in Budget 2019.

Executive summary

Capital Acquisitions Tax (CAT) applies to inheritances and gifts accumulated over a certain tax-free threshold, determined by the relationship of the parties of the parties involved. .

The CAT yield for 2017 was €460 million of which receipts from inheritances were €426m, gifts €33m, discretionary trust €2m, probate less than €1m. Projected yield for 2018 is €472m.

Group thresholds applicable for Capital Acquisitions TAX (CAT)

	Group A	**Group B**	**Group C**
Relationship	Son/Daughter	Parent, brother, sister, niece, nephew, grandchild	Relationship other than Group A or B
Current Group Threshold	€310,000	€32,500	€16,250

The Group A threshold increased in Budget 2016 from €225,000 to €280,000 and in Budget 2017 to €310,000. The Group B and C thresholds increased from €30,150 and €15,075 to their current levels in Budget 2017. The 33 per cent CAT rate is in place since 2012.

The Programme for Partnership Government (PfPG) provides that "We will work with the Oireacthas to raise the Band A CAT threshold (including gifts and inheritances) to €500,000."

To achieve this commitment to raise the Band A Capital Acquisitions Tax Threshold (including all gifts and inheritances from parents to their children) it is estimated by Revenue to cost in order of €69 million in the first year, and €80 million in a full year (concurrent increases in thresholds B and C if agreed would of course increase the overall cost).

The cost of possible changes to the thresholds and the CAT rate are set out below.

Detailed information

The Capital Acquisitions Tax (CAT) code includes gift tax, inheritance tax and discretionary trust tax. Capital acquisitions tax was introduced in the Capital Acquisitions Tax Act 1976 replacing the system of death duties. The Capital Acquisitions Tax Consolidation Act 2003 (CATCA) was introduced into law to consolidate the various CAT related measures, and it has been amended by subsequent Finance Acts.

Changes in the rate of CAT

The current rate of CAT is 33%. The CAT rate has increased incrementally from 20% in 1999-2007, to 22% in 2008, 25% in 2009-2010, 30% in 2011 and has since remained at 33%. The projected yield for CAT in 2018 is €472m.

Table 1 sets out the Exchequer benefit of an increase in the CAT rate.

Table 1

Rate change	€m Full Year
From 33% to 34%	14
From 33% to 36%	43
From 33% to 38%	72
From 33% to 43%	143

Table 2 sets out the cost of a decrease in the rate of CAT.

Table 2

Rate change	€m Full Year
From 33% to 32%	- 14
From 33% to 30%	- 43
From 33% to 28%	- 72
From 33% to 23%	- 143

It is not proposed that there would be a change in the rate of CAT and to the extent that resources exist to provide for improvements that they would be applied to changes in the thresholds.

Changes in the Category A, B and C thresholds

Table 3 sets out the evolution of changes in the three thresholds since 2007. There was a gradual increase in the thresholds up to 2009 at which point the thresholds were significantly reduced. There has been increases in the thresholds in 2015 for Category A and for all the categories in 2016 with no changes since that date.

	Group A	Group B	Group C
On or after 12.10.16	€310,000	€32,500	€16,250
14.10.15-11.10.16	€280,000	€30,150	€15,075
6.12.12-13.10.15	€225,000	€30,150	€15,075
7.12.11-5.12.12	€250,000	€33,500	€16,750
1.1.11-6.12.11	€332,084	€33,208	€16,064
8.12.10- 31.12.10	€332,084	€33,208	€16,064
8.12.09-31.12.09	€414,799	€41,481	€20,740
8,4.09-31.12.09	€434,000	€43,400	€21,700
7.01.09 -.7.04.09	€542,544	€54,254	€27,127
2008	€521,208	€52121	€26,060
2007	€496,824	€49,682	€24,841

It should be recognised that these are lifetime thresholds and apply to all gifts or inheritances received since 1991. Individuals who benefit from the dwelling house exemption (where they live with the disponer three years prior to their death and 6 years thereafter) are entitled to the benefit of the thresholds.

Impact of changes to CAT thresholds

Table 4 sets out the effect on the thresholds and the full year cost of a range of changes to each threshold, where each is increased by 1%, 3%, 5%, or 10%.

Table 4

% INCREASE	*GROUP A (€310,000)*	*GROUP B (€32,500)*	*GROUP C (€16,250)*	*COST OF INCREASE (€M)*
1%	*€313,100*	*€32,825*	*€16,413*	*-4.0*
3%	*€319,300*	*€33,475*	*€16,738*	*-11*
5%	*€325,500*	*€34,125*	*€17,063*	*-18*
10%	*€341,000*	*€35,750*	*€17,875*	*-34*

There are options around increasing or decreasing the thresholds or moving towards a single threshold for Groups A, B and C. However, traditionally, policy over successive periods has been to maintain Group A as the largest threshold. Successive

governments have favoured higher thresholds for parent to child inheritances.

There are equity issues to consider in whether to amend Category A only while making no changes to Category B or C. However, providing for changes to the Category A threshold only allows for movement towards the Government policy position.

Increasing Group B and C thresholds to bring them in line with Group A threshold would be costly, approximately €198 million. This is because a significant element of the yield from gifts and inheritances rise from the Group B threshold.

Effect of changing a Single CAT Threshold

Table 5 sets out the individual cost of changing individual thresholds.

Table 5

Threshold	-10%	-5%	-3%	- 1%	0%	+1%	+3%	+10%
A	27.3	13.6	8.2	2.7	0.0	-2.6	-7.6	-22.4
B	10.1	5.1	3.0	1.0	0.0	-1.0	-3.0	-9.7
C	1.9	1.0	.06	0.2	0.0	-0.2	-0.6	-1.9
Total	39.3	19.7	11.8	3.9	0.0	-3.8	-11.2	-34.0

Table 6 sets out a range of possible options where there is a straightforward change in the rate applying and with percentage increases.

Table 6

CATEGORY A							
	Current Threshold	**Proposed Threshold Increases**				**Pre Budget 2019 Ready Reckoner**	
	€310,000	€ 320,000	€325,000	€330,000	€340,000	€319,300	€341,000
% Increase		3.23%	4.84%	6.45%	9.68%	3%	10%
Full year Estimated Cost		- €8.1m	-€11.8m	-€15.3m	-€21.8m	-€7.6m	- €22.4m

CATEGORY B						
	Current Threshold	**Proposed Threshold Increases**			**Pre Budget 2019 Ready Reckoner**	
	€32,500	€33,500	€35,000	€37,000	€33,475	€ 35,750
% Increase		3.1%	7.69%	13.85%	3%	10%
Full year Estimated Cost		-€3m	-€7.5m	-€12.9m	-€3m	- €9.7m

CATEGORY C						
	Current Threshold	**Proposed Threshold Increases**			**Pre Budget 2019 Ready Reckoner**	
	€16,250	€17,000	€18,000	€ 20,000	€16,738	€ 17,875
% Increase		4.62%	10.77%	23.08%	3%	10%
Full year Estimated Cost		-€0.8m	-€2m	- €4m	-€0.6m	- €1.9m

Officials are available to discuss.

Related submissions

There are no related submissions.

User details

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Submission FIN 00891-18: Tobacco Products Tax Options- Budget19#09

TO: Minister
STATUS: Completed
PURPOSE: For Decision

AUTHOR: Liam Sweetman
OWNER: Liam Sweetman
REVIEWERS: Niall O'Sullivan
Liam Sweetman
Gerry Kenny
John Hogan
Margaret Fitzgerald
Elizabeth Hughes

DIVISION: Tax Division
DECISION BY:

Final comment

Noted. Not currently minded to implement a further increase. PD 15/09/18

Action required

Options around Tobacco Products Tax for Budget 2019

Executive summary

- The Tobacco Products Tax on a 20 pack of cigarettes was increased by a cumulative €2 in the last 5 Budgets; with higher than pro-rata increase on other tobacco products.
- Public health policy targets a reduction of smoking prevalence to 5% by 2025. Taxation policy supports this and the percentage of the population smoking has fallen from 28.3% in 2003 to 17.5% in 2017.
- Receipts from TPT have been consistently above €1 billion in recent years. Regulatory changes in recent year has, however, spurred the practice of front loading by industry making forecasting increasingly more difficult.
- This benefitted the Exchequer in 2017 with 'bumper' receipts of €1.4 billion. However, scarcity follows front loading and the €1.1 billion forecast for 2018 will be in the region of €363m below target by the end of September.
- Moves in the market towards lower-priced and value-sized packs have been observed. The policy issue of cheap cigarettes can, if so desired, be partially addressed by increasing the Minimum Excise Duty.
- Surveys conducted by Revenue indicate an increase in the consumption of illicit cigarettes from 10% in 2016 to 13% in 2017.
- Heated tobacco products could launch in Ireland. Options around the excise treatment of these products are provided.
- The Revenue have advised that market trend forecasts are tentative in the context of front-loading, and that increases in excise may not lead to increased yields.

Detailed information

1. **Background**

1.1 In line with public policy to reduce smoking prevalence to less than 5% of the population by 2025, the excise duty on a 20 pack of cigarettes has been raised in each of the last seven budgets, with a cumulative €2 increase in tax over the last five budgets. These measures have brought the retail price in the most popular price category (MPPC) to €12.20 per pack and the weighted average price (WAP) to €11.22, as of July 2018.

1.2 The table below indicates the price of the MPPC following each Budget and trade increase over the last six years:

BUDGET	VAT & DUTY INCREASE	TRADE INCREASE	PRICE (€)	TAX CONTENT (€)	TAX AS % OF PRICE
2012	44.3c	10.7c	9.20	7.21	78.4%
2013	10c	10c	9.40	7.34	78.1%
2014	10c	10c	9.60	7.47	77.8%
2015	40c	0c	10.00	7.87	78.7%

2016	50c	0c	10.50	8.37	79.7%
2017	50c	50c	11.50	8.95	79.2%
2018	50c	20c (to August 2018)	12.20	9.56	78.4%

1.3 Receipts from excise duty on tobacco has consistently been above €1 billion. Receipts came to €1.4 billion in 2017. However, this figure was artificially inflated due to front loading by the tobacco industry in advance of plain packaging regulations. The forecast for 2018 is €1.1 billion but Revenue estimate that they will be in the region of €363m below target by the end of September.

2. Government and EU Public Health policy and Market Implications

2.1 In October 2013 the Department of Health published *Tobacco Free Ireland, a Report of the Tobacco Policy Review Group*, confirming a target of less than 5% smoking prevalence by 2025, which implied a 74% reduction in the number of citizens smoking between 2013 and 2025. *Tobacco Free Ireland* also proposed TPT increases in five consecutive Budgets and the equalisation of the tax treatment of RYO and cigarettes.

2.2 Progress is being made in reducing smoking prevalence in Ireland and tax policy is considered by many to play an important role in that regard. For example, the percentage of the population reporting smoking, as measured by the HSE National Tobacco Control Office, has fallen from 28.3% in June 2003 to 17.5 % in 2017. The number of smokers consuming a quantity greater than 20 cigarettes a day has also fallen. Correspondingly, the number of cigarettes cleared for consumption fell 27% between 2008 and 2017. While RYO tobacco clearances significantly increased since the recession in 2008 this segment of the market still represents a very small percentage of the overall tobacco consumption in Ireland - accounting for some 10% in excise from tobacco products.

2.2 The commencement order for the Public Health (Standardised Packaging of Tobacco) Act 2015 was signed in March 2017. This Act standardises the packaging of tobacco products manufactured for sale in Ireland, removing all forms of branding including trademarks, logos, colours and graphics from packs. Tobacco products manufactured for retail sale in Ireland must comply with these standardised packaging requirements from end September 2017, while retailers have been given a year from this date to clear stock of old-style, non-compliant products. The measure comes in addition to the new EU-wide packaging standards as part of the Tobacco Products Directive (TPD), which were commenced in May 2016.

2.3 An implication of the transposition of these regulations, and subsequently plain packaging regulations, was the fluctuation of excise receipts throughout the 2016, 2017 and 2018, with front loading followed by a reduced demand by tobacco industry for tax stamps. These regulation driven trends make forecasting increasingly harder and Revenue have indicated that projections for next year are highly tentative.

2.4 The transposition of this TPD has also brought about changes for RYO tobacco products, which now must comply with a minimum pack size containing at least 30g of tobacco. This could have implications for consumer behaviour in this country, where traditionally much smaller 12.5g packs would have been popular. Any substantive impact on the RYO market and consumption patterns will be seen over time**.**

3. Market Trends and Policy Instruments to tackle Cheap Cigarettes and Tobacco

3.1 Since about 2010 there has been a very significant structural change in the price range at which cigarettes are sold. In 2010 about 70% of cigarettes was sold at the Most Popular Price Category (MPPC) reflecting a market with a very high degree of price uniformity. By 2017 only 20% of cigarettes were at the MPPC level, reflecting a much more diverse pricing within the market.

3.2 The main effect of this structural change has been a significant growth in the market share of cheaper cigarettes, with the market shares of value 20 packs and large packs (packs of up to 30 cigarettes, often discounted on a per stick basis) increasing substantially. The impact of the plain packaging regulations will only be seen over the coming years. However, it is considered to have the potential to further drive consumer preferences towards cheaper cigarettes.

3.3 The greater popularity of cheap cigarettes, as with cheap alcohol, is a negative from a public health perspective. It also reduces the Exchequer revenues assuming no changes in volumes purchased in Ireland.

3.4 In light of the trend towards cheaper cigarettes, there have been calls to activate the **Minimum Excise Duty (MED).** Our MED is

currently set at a level whereby all 20 packs priced beneath €7.75 will be taxed as if they were €7.75 – in other words, as a policy tool, it is irrelevant.

3.5 The purpose of the MED is to support public health objectives, tackle the very cheapest cigarettes and promotes fiscal sustainability. The UK introduced a MED in its 2017 Finance Bill and indexed linked this rate to increases in wider cigarette duty. By its nature increasing the MED would impact greatest on the heaviest smokers of the cheapest cigarettes.

3.6 A practical issue with activating the MED is that if it is set at too high a level it could incentivise the growth in illicit cigarettes as well as non-Irish duty paid cigarettes. While there has been a general downward trend since 2010 in the estimated consumption of illicit cigarettes, in 2017 this trend noticeably reversed.

3.7 A further issue with cheaper tobacco relates to the Roll-Your-Own (RYO) category which became more popular following the onset of the recession in 2008. Health lobbyists have consistently argued that the excise duty rates on RYO should be equivalent to cigarettes. Using a weight-to-stick converter formula, the excise on a 20 pack is €7.27 whereas the equivalent excise on RYO is in the region of €5.03.

3.8 However, given that the minimum weight in which RYO can be sold is now 30g this means the cheapest RYO are in the region of €6 more expensive than the cheapest 20 packs – which for those with least disposable income could mean that the cigarettes are more attractive than RYO.

3.9 In Budgets 2015 and 2018 it was decided to increase the duty on a 30g RYO pack by an additional 50% on top of the pro rata increase on pack of cigarettes (20c and 25c respectively). It may be prudent to consider further additional increases on RYO in the forthcoming budget. In the event that you are minded to increase the rates on cigarettes you may wish to follow the decisions in Budgets 2015 and 2015 by increasing RYO rates above and beyond any pro-rata increase provided for.

3.10 In last years budget when cigarettes increased by 50c per 20 pack, the pro rata (VAT incl.) increase for RYO was 68c while the 'top-up' amount was 25c (VAT incl.).

4. Cross-border comparisons

4.1 Ireland currently imposes the highest rate of excise duty on tobacco in the European Union (EU), with the total excise duty per 1000 cigarettes at €357.77. By comparison, the lowest tobacco excises in the EU are Bulgaria's €90.50 and Croatia's €93.23 duty per 1000 cigarettes. In the case of a 20 pack of cigarettes in the current most popular price category (MPPC) of €12.20, the excise duty component is €7.28, and the VAT component is €2.28. This amounts to €9.56 tax per 20-pack, or 78% of the price. The rate of excise duty on Roll-Your-Own (RYO) tobacco is currently €335.342 per kg, or €10.06 per 30g pack of RYO.

4.2 The most recent cross-border price survey carried out by Revenue indicates that the price of an indicative brand of cigarettes is €0.69 cheaper in the State than in Northern Ireland (though the VAT and duty imposed on the product is €0.31 more here than in Northern Ireland). This survey was conducted on 17th May 2018 and is based on the then exchange rate of 0. 8729. The Revenue Commissioners plan to conduct another survey towards the end of September 2018, in advance of the Budget.

5. Non-Irish Duty Paid and Illicit Cigarettes

5.1 The consumption figures above apply only to tobacco products upon which Irish duty has been paid. Results from the latest Ipsos MRBI survey conducted on behalf of Revenue and the HSE National Tobacco Control Office indicate that 13% of cigarette consumption in Ireland in 2017 was illicit, while an additional 9% of cigarette consumption was legal product purchased abroad. This represents a notional loss to the Exchequer in 2016 of some €229 million in excise duty and VAT, assuming that the illicit cigarettes consumed displaced the equivalent full tax paid quantity of cigarettes. The survey has been conducted since 2009, and the results below indicate an overall steady downward trend in the illicit trade, with a reversal in 2017:

YEAR	ILLICIT NON DUTY PAID	LEGAL NON-IRISH DUTY PAID	TOTAL
2009	16%	5%	21%
2010	15%	9%	24%
2011	15%	8%	23%
2012	13%	7%	20%
2013	12%	5%	17%
2014	11%	6%	17%
2015	12%	6%	18%
2016	10%	8%	18%
2017	13%	9%	22%

6. Novel Products

6.1 Heated tobacco products have yet to appear on the Irish market, though the Department of Health have indicated that certain tobacco companies have submitted formal approval notifications to them as required under EU regulations. Subject to approval, this would mean that they are free to launch on the Irish market (though they may not have concrete plans in this regard).

6.2 Revenue have indicated that under current legislation they would be treated for excise purposes as 'other smoking tobacco' were they eligible for launch here. There remains the option, however, to insert a definition of heated tobacco products in the legislation for the purpose of applying a rate of excise duty equivalent to that on cigarettes on these products.

6.3 It is understood that EU Member States where heated tobacco products have launched are taxing them in different ways and at different rates. A 2018 European Commission report on the Tobacco Tax Directive noted that: *"at present, Member States have different approaches towards the tax treatment of these products, varying from taxation at the same rate as smoking tobacco under the current directive (Croatia, Germany, Greece, Latvia, the Netherlands, Slovakia, Slovenia, Romania and United Kingdom) to taxation at a different level on a national basis (Italy, Portugal, Hungary)."* **[1]**

6.4 On a per stick basis there is a high excise gap between the 'other tobacco category' and the 'cigarettes' category which could translate in monetary terms to about €5.80, providing a significant financial incentive to certain consumers not just to switch from cigarettes to heated tobacco products, but for young non-smokers to start off on heated tobacco products. In the absence of broad acceptance in the scientific community that these products are less harmful than cigarettes it may be prudent from a public health perspective to tax these products on a per stick basis at the higher excise rate that applies to cigarettes.

7. Pre-Budget Submissions

7.1 Imperial Tobacco have requested that the MED (Minimum Excise Duty) not be raised, expressing concern that such a measure could drive the most price-sensitive consumers to the illicit trade. Japan Tobacco Ireland have requested that the Department raise the MED to a trigger price of €10.30, and advise against an additional excise increases to RYO products.

7.2 The Irish Heart Foundation (IHF) and Irish Cancer Society (ICS) have recommended a tobacco price escalator of CPI+5% apply to cigarettes (approx. 50c increase each year), and have proposed a levy on the profits of the tobacco manufacturers, similar to the Bank levy introduced in Budget 2014. The introduction of a levy on the profits attributable by the tobacco companies in Ireland would be in recognition of the high profit margins enjoyed by tobacco firms and the harm caused by their products. ASH Ireland have requested a €1 increase on the price of a pack of 20 cigarettes, and propose an additional 50c litter levy on each pack sold. Both the joint IHF and ICS submission and ASH have also recommended that excise duty on roll your own tobacco continue to be increased until it is equal to that on cigarettes.

8. Options

8.1 The estimated yield in a full year of a range of increases in VAT-inclusive duty on cigarettes (with pro-rata increases on (RYO) other tobacco products) is as follows:

Increase (per pack of 20 cigs)	Yield	Additional for 50% on RYO	Total
10c	€11.7m	€0.3m	€ 12.0m
20c	€23.3m	€0.6m	€ 23.9m
30c	€34.9m	€1.0m	€ 35.9m
40c	€46.4m	€1.3m	€ 47.7m
50c	€57.8m	€1.6m	€ 59.4m
60c	€69.1m	€1.9m	€ 71.0m
70c	€80.4m	€2.2m	€ 82.6m
80c	€91.6m	€2.5m	€ 94.1m
90c	€102.7m	€2.8m	€ 105.5m
100c	€113.7m	€3.2m	€ 116.9m

8.2 It should be noted the Revenue Commissioners have expressed concerns that increases in excise may not lead to increased yields, as consumers are further incentivised to exit the tobacco products market in Ireland. Therefore the above yield projections could be significantly affected by market elasticity. For example, in the context of a 25c increase in excise, Revenue's Ready Reckoner has indicated that yields could change within the range of an €21m decrease and a €29m increase. It is also worth noting again that market trends are increasingly harder to predict in the context of front-loading, and thus projections for next year are highly tentative.

8.3 Raising the effective MED would increase the excise due on the lowest priced cigarettes, therefore result in a corresponding price increase (assuming manufacturers will adjust prices to maintain their margins). For example, if the MED was increased to €358.76 per 1,000 (equivalent to €7.18 per 20 pack) – effectively set at a trigger price point of €11.00 – it would add 9.9c in excise to a 20 pack priced at €9.90. If the wholesaler/retailer margins were to remain the same it would cause the price to increase to €10.04 (VAT inclusive). In relation to a large pack of 30 retailing at €14.00, increasing the MED to €358.76 per 1,000 would add 32c in excise and if the wholesaler/retailer margins were to remain the same it would cause the price to increase to €14.32. The table below sets out estimated additional revenues for 2019 (in excise and VAT) from proposed increases in MED to trigger prices of €10, €10.50, €11 and €12.20.

MED 'TRIGGER PRICE'	**€10.00**	**€10.50**	**€11.00**	**€12.20**
Excise	€0.9m	€2.6m	€5.6m	€14.8m
VAT	€0.2m	€0.6m	€1.3m	€3.4m
Total Yield	**€1.2m**	**€3.1m**	**€6.9m**	**€18.3m**

8.4 You may wish to discuss with officials.

[1]https://ec.europa.eu/taxation_customs/sites/taxation/files/report_excise_duty_manufactured_tobacco_12012018_en.pdf

Related submissions

There are no related submissions.

Comments

Helena Quane - 11/09/2018 14:10
As discussed.

Helena Quane - 18/09/2018 09:17
Noted. Not currently minded to implement a further increase. PD 15/09/18

User details

INVOLVED:	Liam Sweetman	READ RECEIPT:	Liam Sweetman
	Niall O'Sullivan		Niall O'Sullivan
	Gerry Kenny		Gerry Kenny
	John Hogan		John Hogan
	Sub_FIN Sec Gens Office		Margaret Fitzgerald
	Derek Moran		Deborah Sweeney
	Sub_FIN Ministers Office		Helena Quane
	Minister Donohoe		Elizabeth Hughes
			Mary Ryan
			Aidan Murphy

Pre-Budget submission on Alcohol Products Tax

Final comment

I am currently minded to make no changes. Will review in final days before Budget. PD 20/09/18

Action required

Budget 19#11 - options in respect of Alcohol Products Tax

Executive summary

Main points

- Receipts from APT were €1,220m in 2017 and are forecast to be €1,236m for 2018. They are currently running slightly ahead of target.
- Ireland imposes amongst the highest rates of excise on alcohol products in the EU in line with public policy objectives to reduce alcohol consumption to OECD average levels.
- The excise component of drinks sold as a percentage of the retail price in the on-trade has remained stable in recent years. It comprises about 12% of the price of a pint.
- A Revenue cross border survey in May 2018 indicates a significant price differential across many alcohol products between Dublin and Newry, with Dublin being dearer.
- Industry pre budget submissions call for reductions in Ireland's high level of excise and makes reference to the sector specific Brexit risks.
- Options for increasing the rates are presented in this submission.

Detailed information

1. **Background**

1.1 The main policy considerations regarding the Alcohol Products Tax are:

- public health policy is to reduce alcohol consumption to below the OECD average.
- revenue raising to account for the negative externalities associated with excessive alcohol consumption.
- recognition of the contribution of the sector to jobs, regional economy, etc.
- the potential loss of revenues arising from cross border trade.
- the revision of the Alcohol Tax Directive.

2. Public Health Policy and Recent Consumption Trends

2.1 The *Healthy Ireland Strategy*, published by Government in 2013, which outlined a high-level framework and targets for public health policy, included an objective of reducing alcohol consumption to below the OECD average.

2.2 The Steering Group Report on a National Substance Misuse Strategy, published in 2012, provides a set of public health policies related to alcohol consumption. The Report made four recommendations relating to excise duty: maintain excise rates at high levels; further increase excise rates for higher alcohol content products; increase the differential between excise rates applied to alcohol content levels in each alcohol product category; and increase the annual excise fee for the renewal of Off Licences.

2.3 The consumption of alcohol per capita (aged 15 and older) in Ireland was on a downward trajectory from 2001 to 2009 but has been broadly stable at between 10.5 and 11.5 litres since 2010. In 2016 it is recorded at 11.2 litres, above the OECD average of 9.2%.

2.4 For the first 5 months of 2018, compared to the same period last year, *clearance* of beer rose by 4.3%, spirits by 8.3% and wine by 2.2% compared with the first 5 months of 2017. Clearance of cider fell by 4.4%.

3. Excise and Retail Price Trends

3.1 Alongside the UK and Scandinavian countries, Ireland applies high excise duties on alcohol products relative to other EU countries. However, excise duties on alcohol have remained unchanged since 2014.

3.2 The yield on alcohol products taxation has remained stable in recent years at c€1.2 billion per annum. Yields from 2017 contributed 2.4% of Exchequer tax revenue.

3.3 Excise duty as a proportion of the sales price across all alcohol types has remained broadly stable since 2014 at, in the on trade: c12% of the price of a pint of lager/stout; and, in the off trade: c25% of the price of a 500ml can of lager/stout, c30% of the price of a 750ml bottle of wine and just under half the price of a 700ml bottle of whiskey.

3.4 Excise on Alcohol Products is forecast for €1.236 billion in 2018 and is currently broadly on target.

4. **Cross Border comparison**

4.1 Price differences between the South and North are determined by (i) VAT and excise rates in both jurisdictions, (ii) exchange rates, and (iii) the pricing strategies of retailers. Given that the UK imposes similarly high rates of excise duty on alcohol products, the most important determinant of price differentials is usually the exchange rate.

4.2 Revenue conduct a cross border (Dublin & Newry) price survey on excisable goods bi-annually. In its May 2018 survey (based on the exchange rate on the day of the survey: €1 = £0.8728) it was found that there are significant price differences, with Dublin being substantially more expensive for wine, whiskey, vodka and lager while stouts prices being very similar.

4.3 [redacted]. Looked at from a Southern perspective: A bottle of Whiskey is €3.57 cheaper in the north, a bottle of Vodka is €4.52 cheaper in the north. Jacobs Creek wine is €2.15 cheaper in the north, and Gallo wine is €1.72 cheaper in the north.

5. Minimum Unit Pricing (MUP) and Cross Border dimension

5.1 The Public Health (Alcohol) Bill is currently awaiting the scheduling of Report Stage before the Dáil and will provide for the introduction of minimum unit pricing for alcohol here.

5.2 MUP is already in place in Scotland having overcome the legal challenge of the Scottish Whiskey Association. The proposed MUP in the Public Health (Alcohol) Bill is 10c per gram of alcohol while the Scottish MUP is 50p per unit of alcohol, which on current exchange rate translates to about 7c per gram of alcohol.

5.3 The introduction of MUP here should be subject to a similar simultaneous proposal being introduced in the North. Otherwise, the probable outcome of introducing MUP solely in the South would be an increase in cross border trade in alcohol as well as other products while not achieving the health outcomes sought. The Bill as published is subject to commencement order by the Minister.

6. Pre Budget Submissions

6.1 Pre budget submissions were received from The Drinks Industry Group of Ireland, National Off-Licence Association (NOffLA) and the Vintner's Federation of Ireland. The requests in

these submissions have been similar, among other things, calling for a 15% reduction in alcohol excise. Specific references to the potentially serious negative impact of Brexit on the industry were also made, in view of the trading links, integrated supply chains and the all-island dimension to this.

7. Options for increasing excise rates

7.1 Increases in excise duties on alcohol products, similar to those applied in Budget 2014 (i.e. 10c on a pint of beer and cider, 10c on a glass of spirits and 50c on a bottle of wine) would yield an estimated €146.2 million in a full year.

7.2 The following table shows the estimated effect of a range of VAT inclusive increases:

	Full Year 5c	**Full Year 10c**	**Full Year 15c**	**Full Year 20c**
Beer (per pint)	€34.0m	€67.6m	€100.7m	€133.5m
Spirits (1/2 glass)	€19.8m	€38.9m	€57.4m	€75.1m
Cider (per pint)	€4.9m	€9.7m	€14.4m	€19.1m

	Full Year 25c	**Full Year 50c**	**Full Year 75c**	**Full Year 100c**
Wine (Bottle)	€15.5m	€30.0m	€43.4m	€55.7m

7.3 You may wish to discuss with officials.

27 August 2018

Budget 19#10 Betting Tax Options

REF #:	FIN 00774-18	AUTHOR:	Clare McCabe
TO:	Minister	OWNER:	Clare McCabe
STATUS:	Completed	REVIEWERS:	Niall O'Sullivan, Gerry Kenny, Clare McCabe, John Hogan, Margaret Fitzgerald
PURPOSE:	For Discussion	DECISION BY:	
DIVISION/OFFICE:	Tax Division		

Final comment

I note that this tax is paid both by traditional and on-line bookmakers. What share of betting revenues are accounted for by grey-hound and horse racing? Increase by 1% in Budget '19. PD 15/09/18

Action required

Budget 2019: Betting Tax Options

Executive summary

- The Betting (Amendment) Act 2015 extended the betting duty to the remote sector thus levelling the playing field for all bookmakers.

- Traditional and online bookmakers are now both liable to pay the 1% betting duty, whilst online betting intermediaries are required to pay a duty of 15% of the commission they charge to customers in the State.

- Pros and Cons of increasing the rate of duty are set out including the potential effect on Exchequer receipt and the bookmaking industry.

Comments

John Hogan - 30/08/2018 09:03
As requested

John Hogan - 11/09/2018 15:13
As requested

Clare McCabe - 11/09/2018 15:29
Title amended to include Budget Number - #10

Helena Quane - 18/09/2018 09:14
I note that this tax is paid both by traditional and on-line bookmakers. What share of betting revenues are accounted for by grey-hound and horse racing? Increase by 1% in Budget '19. PD 15/09/18

Detailed information

Background

1. There has been ongoing pressure to increase the betting excise duty. This has been driven by a number of issues including the historical link between betting revenues and the funding of the horse and greyhound industry.

2. To date, the priority has been to extend the betting duty to remote operators and betting intermediaries through the enactment of the Betting (Amendment) Act 2015 and to allow time for the new regime to bed in.

3. Implementing betting tax increases prior to 2015 would have run a significant risk of simply undermining domestic bookmakers but given that remote operators and betting intermediaries are now well embedded in the scope of the betting tax regime, it may be an opportune time to consider rate increases.

4. While the Betting Acts 1931-2015 comprehend the licensing and regulation of the bookmaking sector, the Minister for Justice is working on a scheme for a Gambling Control Bill which will provide for a comprehensive, modern regulatory framework to cover all forms of gambling and afford the greatest protections to those that need it most.

Current Tax Rates and Receipts

5. Both traditional and online bookmakers are liable to pay the 1% betting duty on turnover. Online betting intermediaries are required to pay a duty of 15% of the commission they charge to customers in the State.

6. The widening of the tax base by the inclusion of remote betting operators and intermediaries into the tax net resulted in an increase of betting tax receipts, from €26.1m in 2014 to €50.7m in 2016.The receipts have remained around this level since then, with 2017 receipts totalling €52.2m and 2018 receipts set to be in the same ballpark.

Budget Options

7. A 1% increase in betting duty with a commensurate increase in the rate charged on the commission of Betting Intermediaries is estimated to generate an additional €50m in receipts.

8. A move away from the current system towards a gross profits tax or a tax paid by the punter, while possibly allowing for a greater increase in revenues, would require a change in approach and systems for both Revenue and industry so alternative approaches are not considered in the context of Budget 2019.

Pros & Cons for increase betting duty rates

9. While international comparisons are difficult as countries apply differing models of betting duty sometimes with different goals in mind, the indications are that the Irish tax rate is low by international standards. Where duties are levied or partly levied on the basis of turnover in EU Member States (e.g. France, Germany, Portugal), the rates are much higher than Ireland. Historically, the betting tax rate has not been increased since 1977 when it was then increased to 20%. From 1985 to 2006 the rate has been gradually reduced to the current level of 1%.

10. Raising the tax rates could risk the following:

- disproportionately impacting on smaller retail betting operators, as larger operators are in a better position to absorb the higher tax liability. [redacted]
- deflecting a small proportion of punters from betting operators and intermediaries to alternative forms of betting which do not incur an excise tax e.g. lotteries, casinos, arcades, bingo and illicit venues.

11. Finally it should be noted that, in the context of the historical link between betting revenues and the funding of the horse and greyhound industry, any increase in betting receipts will be seen by some in the industry as being earmarked for the Horse and Greyhound Fund, which is currently in receipt of c€80m of annual State funding from the Agriculture Vote, some €27m more than current betting duty receipts.

You may wish to speak to officials.

30th August 2018

Related submissions

There are no related submissions.

[redacted]

Submission FIN 00892-18: Bud19#7 VAT Issues

TO: Minister
STATUS: Completed
PURPOSE: For Decision

AUTHOR: Blaithin Nic Giolla Rua
OWNER: Blaithin Nic Giolla Rua
REVIEWERS: Gerry Kenny
John Hogan
Margaret Fitzgerald

DIVISION: Tax Division
DECISION BY:

Final comment

Thanks. Very clear. Again let's look at in tax process. PD 31/08/18

Action required

To note Budget options in relation to VAT rates, including Programme for Partnership Government proposals.

Executive summary

This submission is in three parts:

- Part 1 looks at revenue raising options for changing the existing VAT rates.
- Part 2 looks at the 9% VAT rate and options in this regard.
- Part 3 looks at other VAT-related Programme for Partnership Government objectives.

Detailed information

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Part 1: Options for Revenue Raising

1. The cost of increasing or decreasing the VAT rates by 1% is outlined as follows. These are full year figures and would be 1/6th lower in the first year because VAT is paid two months in arrears.

Rate	1% increase / decrease
9% reduced rate	+/- €133m
13.5% reduced rate	+/- €230m
23% standard rate	+/- €463m

2. Increasing VAT rates may negatively affect inflation. The 13.5% rate applies to domestic fuels, construction, housing, labour intensive services and general repairs and maintenance. Accordingly, an increase in this rate may affect employment and the less well off. An increase in the 23% rate may encourage cross-border shopping.

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Part 2: Options around the 9% VAT rate

Cost/EU Comparison

3. Revenue's most recent estimate for reverting the reduced 9% VAT rate back to 13.5% is that it would bring in extra revenue of €598 million. The estimated cost to the Exchequer of the reduced 9% VAT rate, since its introduction in 2011 to end 2017, is €2.6 billion.

4. Ireland's 9% rate is among the lowest VAT rates in the EU on hotel accommodation and restaurants. Ireland has the 6th lowest VAT rate on restaurants in the EU, along with Romania and Cyprus. In addition, Ireland's VAT rate on hotel accommodation is the 8th lowest in the EU, along with Romania, Lithuania, Cyprus, Estonia and Bulgaria.

5. If the 9% VAT rate was increased to 13.5%, Ireland would have the 15th lowest VAT rate on restaurants in the EU, or the 14th highest. If hotel accommodation was reverted to 13.5% Ireland's VAT rate would be the 6th highest in the EU. Only 3 Member States, including the UK, apply the standard rate to hotel accommodation. 11 Member States apply their standard VAT rate to restaurant services.

History of the 9% VAT Rate

6. The 9% rate was introduced as a temporary measure as part of the Jobs Initiative in 2011 until December 2013. From Budget 2014 it was decided to retain the 9% rate to support the increased number of jobs and, in latter years, because of the weakness in Sterling following Brexit. However, you decided after Budget 2018 to undertake a study on the 9% rate, and the Department's "Review of the 9% VAT rate Analysis of Economic and Sectoral Developments" was published in July 2018 along with the TSG papers. The Review assesses the 9% VAT rate's relevance, cost, value-for-money, impact to date and the estimated impact were it to be removed.

Summary of main findings of the Department's Review of the 9% rate

7. A summary of the main findings in the Department's Review of the 9% VAT rate is as follows:

- ***VAT rate/Price less relevant than income:*** Expenditure on 9% goods and services largely represents discretionary expenditure by households. This form of expenditure is particularly sensitive to income growth and to the economic cycle, more so than to price changes. Exchange rate fluctuations have proven not to deter tourism. The VAT rating applied to the tourism sector therefore is also less significant.
- ***Employment*:** The accommodation and food services sector had the second highest average employment growth rate since 2011, after construction. Employment levels in the sector recovered quickly and surpassed their previous peak in the second half of 2014. Indeed, August's Labour Force Survey data from the CSO showed continued strong annual employment growth in the sector of 11% in Q2 2018, again the second highest sectoral growth rate behind construction.
- ***Uncompetitive prices*:** Inflation was much greater since 2011 in the 9% sectors than for the economy as a whole, and for other comparable sectors. Productivity fell and unit labour costs rose. Growth in turnover and profit was much higher than in wages. Prices in the accommodation sector increased to a much greater extent than any other sector.
- ***Deadweight Loss:*** Continued stimulus could create productivity challenges for the economy, through misallocation of capital (i.e. excess investment in the sector at the expense of more productive uses) and labour.
- ***Tourism marketing:*** Growth in tourism revenue and numbers across all markets, including from Britain, is driven by successful marketing campaigns (the Gathering, Wild Atlantic Way, Ancient East, etc).
- ***Rural/urban competitiveness:*** All regions experienced tourism growth since 2011; with more accruing to the Dublin, Southwest, and West regions. Indeed all regions experienced growth from all markets (including domestic).
- ***IMF/OECD/EU analysis:*** Each institution has recommended the elimination of the rate.
- ***Regressive:*** Better-off households benefit proportionally more than worse-off households as 9% activities relate to discretionary expenditure.
- ***Not relevant to B&Bs:*** There are three times as many non-VAT-registered B&Bs nation-wide in comparison to VAT-registered. Thus, a significant proportion of regional B&Bs do not benefit from the reduced rate. Furthermore, non VAT-registered B&B's, despite being larger in number than their VAT registered counterparts, have on average, 70% less earnings than VAT-registered B&Bs. Thus, smaller and less profitable B&Bs are unlikely to be affected by a change in the rate.
- ***Increase won't impact demand/employment:*** The current economic climate and the strong demand in the tourism sector

means a rate increase will not affect employment. The available evidence suggests that the majority share of 9% rate sectors, in particular, hotels and restaurants, have scope to absorb a higher VAT rate via the healthy profit margins within these sectors. Nonetheless, as is evident by the positive economic outlook, the income channel of demand is likely to ensure that economic activity within the 9% rate sectors remains strong.

- ***UK tourism and Brexit:*** Despite the recent depreciation of Sterling, inbound tourism remains strong. While numbers are down somewhat on 2016, that year was the record year for UK visitors, and numbers are up on 2017, which itself was the second highest. Trips to Ireland in May and June of this year are actually up slightly on the same two months in 2016, i.e. the two months preceding the Brexit referendum. Furthermore over half of all bed nights from UK visitors took the form of staying with 'friends and family', far higher than any other overseas group, and as such would not be impacted by a change in accommodation VAT rates.

Reverting individual activities from the 9% VAT rate to 13.5%

8. There are a number of options in respect of activities at the 9% rate:

(i) increase the VAT rate for all activities; which would generate an estimated €133m for every 1% increase up to a total of €598m in a full year.

(ii) revert only certain activities back to 13.5% while leaving others at 9%. The table below sets out the estimated yield to the Exchequer where the VAT rate for specific activities is reverted back to 13.5%. As at paragraph 1 above, these are full year figures and would be 1/6th lower in the first year because VAT is paid two months in arrears.

ACTIVITY	REVERT TO 13.5%
Tourist accommodation	€236m
Restaurants	€192m
Hairdressing	€31m
Newspapers	€18m
Bloodstock Sales	€8m
Cinemas	€5m

9. Further detail on the impact of an increase in VAT on each of the activities within the 9% VAT rate is outlined in the Appendix.

Impact on consumers

10. The following illustrates examples of price changes in meals where the 9% rate is reverted to 13.5% and where the full amount is passed through to the consumer:

Current Price	New Price	Price Increase	Assumption
€3	€3.12	12c	
€10	€10.33	33c	includes €2 soft drink
€50	€51.65	€1.65	includes €10 bottle wine

Industry and other views

11. Officials met with the Minister for Transport Tourism and Sport to explore options around the 9% rate. In particular, the Minister was anxious to follow up on media reports to the effect that it may be possible to address high priced accommodation in the Dublin area. It was pointed out that the VAT Directive did not allow for regional disparities in the operation of the VAT system, nor did it allow for different rates in respect of what is effectively the same service.

12. The Restaurants Association of Ireland pre-Budget submission expresses its support for the retention of the 9% VAT rate on the basis of an economic report commissioned by the RAI, which outlines the increase in employment and the uncertainty around

Brexit.

Conclusion

13. The 9% VAT rate was designed to create jobs and was retained on condition that prices remain competitive. The findings of the Review of the 9% VAT rate illustrate that the 9% sectors are no longer competitive and that an increase in the VAT rate is not expected to impact on employment. Furthermore, as the Review finds that the tourism sector is more responsive to income levels than price, there is less relevance and justification for applying a low VAT rate to these sectors.

Part 3: Programme for Partnership Government Measures

Consider introducing a 9% VAT rate on residential construction

14. *"Consistent with our existing deficit reduction targets, we will ask the Oireachtas to consider the merits of a temporary targeted reduction of the rate of VAT from 13.5% to 9% on new, affordable houses and apartments, both public and private, timed to generate the maximum impact on supply and to target principally the purchasers of affordable homes." page 25*

15. In the context of Budget 2017, the Oireachtas Committee on Housing and Homelessness reviewed the costs of construction including VAT, in the light of the Programme for Partnership Government commitment. In their June 2016 Report, they recommend that the Housing Agency annually review construction costs but did not recommend that the VAT rate on new residential property be reduced.

16. It was decided at that time that a more effective aid to home purchases was through the income tax system and the Help to Buy incentive was introduced to this effect. One of the main aims of the incentive is to make mortgages more accessible to first-time buyers.

Work with EU to reform difficulties faced by community re VAT rates on certain products e.g. defibrillators

17. *"We recognise the difficulties faced by community groups in relation to VAT rates on certain products (e.g. defibrillators). While this is an EU competency we will work with our EU counterparts in seeking to reform this area." page 43*

18. Any changes to VAT rates outside of what is currently permitted by the EU VAT Directive must be negotiated at EU technical working groups and ultimately agreed by the EU Council of Finance Ministers. A proposal looking at VAT rate policy across the EU was published in January 2018. This may offer Member States more flexibility in the future in determining VAT rates applicable to goods and services, including defibrillators. However, the effect on community groups can only be determined following discussion and agreement of the proposal.

19. While specifically referencing "defibrillators", the PPG commitment refers to "certain products" that pose difficulty for community groups. Budget 2018 introduced a VAT Compensation Scheme for Charities which will commence in 2019 in respect of VAT incurred in 2018. This should also assist community groups.

Retain 9% VAT rate on Tourism

20. *"We will work towards achieving the ambitious tourism policy goals set for 2025. These include increasing revenue from*

overseas visitors to €5 billion, growing employment in the tourism sector to 250,000 (from 200,000 currently) and increasing the number of visits to Ireland to 10 million. We will do this through the national tourism policy and through specific measures like the maintenance of the 0% Airport Travel Tax and the retention of the hugely successful 9% VAT rate on tourism related services, providing that prices remain competitive." Page 45/6

21. This measure has already been discussed under Part 2.

22. You may wish to discuss with officials.

29th August 2018

Appendix

Impact of an increase in VAT on Each 9% VAT rate Activity

Restaurants and holiday accommodation

The restaurant and hotel accommodation sectors, which account for ¾ of activity at the 9% rate, have seen a very strong recovery since 2011 in terms of private consumption, employment, turnover and profit. Employment in the hotel sector increased by 29% over 2011 to 2016, compared to 41% for restaurants and 36% for all 9% rate activities.

There is a lack of competitiveness in these sectors, with unit labour costs in hotels and restaurants having risen by 14%, compared to a 5% fall for the 'domestic economy' (i.e. excluding some of the high tech foreign MNE dominated sectors). This has been driven by a fall in productivity with a 4% fall in the sector, compared with an improvement of 11% for the 'domestic economy'.

For hotels and restaurants, profits have grown relatively faster than wages and turnover. Profit margins increased by 53% for hotels and restaurants from 2011 to 2016. While prices have increased for 9% sectors overall, compared with 3% for the overall HICP, and 8% for other services, the greatest increase has been in accommodation (+17%), with restaurants (+7%) broadly in line with 'other services'.

The Department's report found that the 9% rate is regressive, with discretionary expenditure on hotels and restaurants benefitting better-off households disproportionally more than worse-off households, a view also shared by the OECD.

The evidence in the Department's report suggests that hotels and restaurants have scope to absorb a higher VAT rate because of the healthy profit margins within these sectors.

Newspapers

Newspapers have seen a reduction in print sales relating to changing consumer preferences over time. This is a structural change in the industry unrelated to the economic cycle, as consumer preferences have altered in favour of online rather than offline content.

Employment in the publishing sector fell by 13% over 2011 to 2016, while all other 9% rate activities saw a growth in employment in that time with the exception of cinemas. However, the share of value-add that goes to wages rather than profit in the publishing area is low at 6%, compared to 77% for hotel and restaurant services, and 32% for the whole economy.

Cinemas

Cinemas, along with publishing, were the only 9% rate sectors that experienced a fall in employment between 2011 and 2016. While the 13% fall in employment in publishing is explained by a structural decline in the sector the same cannot be said of the 19% fall in employment in cinemas, which is generally profitable. When the OECD pointed to the lack of progressivity of the 9% VAT rate, they specifically drew attention to cinemas, as well as restaurants and hotels.

Theatres, certain musical performances

Data on the economic impact of the 9% rate on theatres is limited. Indications are that profits in the area of creative and cultural pursuits did not increase between 2011 and 2016, however, specific figures for theatres are not available.

Museums, art gallery exhibitions

Employment in the museum sector increased by 14% over 2011 to 2016. Indications are that profits in the area of creative and cultural pursuits did not increase between 2011 and 2016.

Facilities for taking part in sporting activities

Employment in the sport sector increased by 5% over 2011 to 2016. The profit share for sporting activities increased by 12% over 2011-2016 and the price mark-up by 14%.

Fairgrounds or amusement park services

Employment in amusement parks increased by 74% over 2011 to 2016, which is one of the highest levels of growth among 9% activities. The profit share for amusement parks increased by 12% over 2011-2016 and the price mark-up by 14%.

Hairdressing services

Employment in hairdressing increased by 25% over 2011 to 2016. The relative share of profit and labour income in hairdressing was unchanged over 2011 to 2016, however, profitability over this time increased by 13% while price mark-ups slightly decreased. Furthermore, studies have shown that hairdressing services are twice the cost in Ireland compared to Northern Ireland, despite the fact that a 20% rate applies to the service in the North compared to 9% here.

Horses and greyhounds not supplied for agricultural or food purposes

It should be noted that the supply of horses and greyhounds were not reduced from 13.5% but had previously applied at the 4.8% rate. The greyhound industry has reported lower employment over time but higher attendance by overseas tourists at greyhound races due to increased marketing efforts. The horse-racing industry has witnessed eight consecutive years of increased sales in Irish bloodstock and employment increased by 19% over 2011 to 2016. The number of horse-breeders, in particular, has doubled over this time period.

Historic houses and open farms

The supply of historic houses and open farms were not reduced from 13.5% but had previously been exempt from VAT.

Employment in historic houses increased by 155% over 2011 to 2016, which is by far the highest level of growth among 9% activities. Indications are that profits in the area of creative and cultural pursuits did not increase between 2011 and 2016, however, specific figures for historic houses and open farms are not available.

Related submissions

There are no related submissions.

Comments

Helena Quane - 31/08/2018 14:33
Thanks. Very clear. Again let's look at in tax process. PD 31/08/18

User details

INVOLVED: Nicholas Fitzgerald
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Action log

ACTION	USER	DATE	DESCRIPTION
Create	Blaithin Nic Giolla Rua	29/08/2018 11:12	Submission FIN 00892-18 to Minister created.
Add involved user	Blaithin Nic Giolla Rua	29/08/2018 12:08	Submission shared with Nicholas Fitzgerald.
Submit for review	Blaithin Nic Giolla Rua	29/08/2018 12:08	Submission sent for review to Gerry Kenny.
Take ownership	Blaithin Nic Giolla Rua	29/08/2018 12:20	Submission ownership taken by Blaithin Nic Giolla Rua.
Submit for review	Blaithin Nic Giolla Rua	29/08/2018 12:26	Submission sent for review to Gerry Kenny.
Submit for review	Gerry Kenny	29/08/2018 14:47	Submission sent for review to John Hogan.
Submit for review	John Hogan	29/08/2018 17:49	Submission sent for review to Secretary General.
Submit for review	Margaret Fitzgerald	29/08/2018 17:57	Submission sent for review to Minister.
Complete	Helena Quane	31/08/2018 14:33	Submission completed by Helena Quane.
Submission sent	Gerry Kenny	14/09/2018 17:03	Submission sent by email to Gerry Kenny.

Submission FIN-00892-18 - Bud19#7 VAT Issues

To: Minister	**Author:** Blaithin Nic Giolla Rua
Status: For Review by Minister	**Owner:** Sub_FIN Ministers Office
Purpose: For Decision	**Reviewer:** Gerry Kenny, John Hogan
Division/Office: Tax Division	
Decision By:	

Minister's Comments:
Thanks. Very clear. Again let's look at in tax process. P. D 31.8.18

Submission FIN 00745-18: Economic report on the 9% VAT rate

TO:	Minister	AUTHOR:	Brendan O'Connor
STATUS:	Completed	OWNER:	Brendan O'Connor
PURPOSE:	For Decision	REVIEWERS:	Elizabeth Hughes
DIVISION:	Budget & Economics Division		
DECISION BY:			

Final comment

Noted. As this report makes clear these are not my views or the views of the Government. Will be a helpful contribution to approaching debate. PD 18/07/18

Action required

Permission sought to publish this report alongside, or shortly after, the publication of tax strategy group papers

Executive summary

The attached report was produced by the Economic Division, and considers the relevance of the 9% VAT rate in the context of the changed economic environment, and developments within the sectors covered by the reduced rate. The main findings are as follows:

- There is a significant ongoing cost, estimated at €490 million in 2017, and €2.6 billion cumulatively since 2011.
- The economic environment has changed considerably since its introduction in July 2011. Accommodation and food services – the majority of activities covered by the 9% rate – has seen the second highest average employment growth rate since mid 2011.
- Within the sector, output and expenditure have risen, wage growth has been positive, though turnover and profits have grown at a faster rate.
- Tourism revenue and numbers are up across all markets, including Britain and domestic.
- Price inflation in 9% rate sectors is much higher than for the whole economy, and for other services, while competitiveness and productivity challenges are also identified in these sectors.
- Expenditure on 9% rated goods and services largely represents discretionary expenditure. This form of expenditure is also particularly sensitive to income growth and to the economic cycle, more so than prices changes. At the same time the 9% rate has had a regressive impact, benefitting better-off households proportionally more than worse-off households.
- Overall demand for these goods and services is not expected to be materially affected by a rate increase.

Detailed information

The attached report sets out the Department's economic review of the 9% VAT rate. The review was conducted by the Economic Division. The main findings, as set out below, were presented to the Tax Strategy Group on 10 July.

Main Findings

The economic context in which the 9% VAT rate operates has changed considerably since its introduction in July 2011. The measure was introduced following a deep recession during which the unemployment rate increased by approximately 10 percentage points over the previous four years. The recovery is now in a mature phase – the unemployment rate is approaching 5 percent, with the level of employment surpassing its pre-crisis peak earlier this year as the labour market approaches ‘full employment’.

At a sectoral level, 'accommodation and food services' – the majority share of sectors covered by the 9% rate – has seen the second highest average employment growth rate since the second half of 2011, superseded only by the construction sector. In the period following the introduction of the 9% rate, employment levels in the targeted sectors recovered. They surpassed their previous peak in the second half of 2014, while all other services only regained peak employment levels in early 2016. While a separate report by the Revenue Commissioners found a positive impact of the lower rate on employment in the sector over a short-term horizon following its introduction (i.e. to 2012), over a longer period it was not possible to distinguish the impact of the reduced rate from other economic factors.

This is a relatively buoyant period for tourism in Ireland, with increases in visitor number from all external markets, including continued growth from Great Britain, as well as domestic tourism. This positive development has likely arisen in the context of successful marketing campaigns and other non-VAT policy interventions, in addition to income growth domestically and overseas.

Expenditure on 9% rated goods and services largely represents discretionary expenditure by households. This form of expenditure is also particularly sensitive to income growth and to the economic cycle, more so than prices changes. Household disposable income growth has been growing consistently in recent years, and is expected to increase further over the medium-term. Therefore, demand for 9% rate activity looks particularly strong at present. However, this report also finds that the 9% VAT rate is regressive, benefitting better-off households proportionally more than worse-off households.

Within the sector, wage growth has been positive, though turnover and profits have grown at a faster rate, with the overall profit share of value-add rising as a result. Both output and consumer expenditure in the sector have risen consistently since 2011. However, consumer price inflation in 9% rate sectors is much higher than for the whole economy and for 'other services', while competitiveness and productivity challenges are identified in these sectors. Unit labour costs for accommodation and food services have risen by about 14 percent since the introduction of the reduced rate, compared with a decline of 20 percent for the whole economy and 5 percent for the 'domestic economy' (i.e. excluding sectors dominated by foreign multinationals). The level of labour productivity has also declined since 2011, compared with an improvement for the domestic economy.

Finally, the report considers the impact of increasing the 9% VAT rate. Given the positive outlook for both household incomes and consumer demand, it is likely that demand for these goods and services will not be materially affected by a rate increase, particularly given that demand is considerably more sensitive to changes in income than price. Furthermore there appears to be scope for the some of the rate increase to be absorbed by the sectors, given the available evidence on turnover and profit. Unemployment is not viewed as a likely impact of increasing the rate, given the outlook for demand in the sector, and the overall prospects within the labour market more generally.

Concerns that removal of the reduced rate would have asymmetric impacts for smaller business may be overstated. For example the vast majority of B&Bs nationwide are not VAT-registered, and thus do not benefit from this reduced rate. Furthermore, the non-VAT registered firms comprise only a small proportion of overall B&B earnings across the State – further illustrating that smaller or less profitable B&Bs are not affected by the 9% rate.

The ongoing and cumulative cost of the reduced rate are substantial, estimated at €490m in 2017, and €2.6bn in total since its introduction. The scale of these costs against the limited benefits point to significant deadweight. Furthermore, with an economy close to full capacity, further stimulus in the sector will only lead to a misallocation of resources (capital and labour) - further adding to overheating pressures and aggregate productivity challenges.

Regardless of the mechanism of effect, increased employment levels within these sectors imply that the original objective of the 9% rate was met and the reduced rate is no longer relevant in the current and forecasted economic climate. The Programme for Partnership Government established that retention of the 9% rate would be contingent upon price competitiveness within the sectors. The analyses has concluded that the majority of these sectors, and hotels and restaurants in particular, have experienced a loss in competitiveness and rising prices relative to comparable sectors.

Next Steps

It is recommended that this report be published alongside, or shortly after, the publication of the Tax Strategy Group papers in late July.

Related submissions

There are no related submissions.

Comments

Brendan O'Connor - 19/07/2018 09:10
Submission cleared remotely by Mr John McCarthy (Chief Economist) on 18 July.

Elizabeth Hughes - 19/07/2018 09:14
For approval subject to final editorial changes-SG

Helena Quane - 20/07/2018 08:09

Noted. As this report makes clear these are not my views or the views of the Government. Will be a helpful contribution to approaching debate. PD 18/07/18

User details

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